SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 680

IRVING J. REUTER, *Petitioner,*

vs.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

I.

The Opinion of the Court Below.

The opinion and judgment of the Court of Claims of the United States in this proceeding was entered October 7, 1940, and is published in 34 Fed. Supp. 1014.

II.

Statement as to the Jurisdiction.

The jurisdiction of this Court is invoked on the following grounds:

1. The judgment to be reviewed was originally entered by the Court of Claims on October 7, 1940. Time to apply for a writ of certiorari runs from that date.

2. In this case plaintiff sued in the Court of Claims to recover from the United States the amount of an income tax deficiency and interest thereon under authority of Section 145 of the Judicial Code.

3. This Court has jurisdiction to grant certiorari under Section 240 of the Judicial Code as amended by the acts of February 13, 1925, and May 22, 1939, 53 Stat. 752.

III.

The Questions Involved.

The question immediately involved in this proceeding is whether Section 22(a) of the Revenue Act of 1934 requires that the grantor of a trust be taxed on the income thereof where the trust is irrevocable for a period of years, is subject to revocation in the future only upon the happening of certain contingencies, where the income is payable to beneficiaries other than the grantor and where, if not revoked, the corpus is distributable to named remaindermen other than the grantor. By implication, decision of this question involves a determination whether such a trust is without substance and whether its corpus is to be treated as the property of the grantor, with the result that the grantor must pay tax on income which he never receives and which is derived from property which he has transferred, perhaps permanently, subject only to a contingent revestment.

IV.

Assignments of Error.

1. The Court of Claims erred in failing to decide that the Janirv Trust was not a trust, the income of which is taxable to the grantor by reason of the provisions of Section 166 of the Revenue Act of 1934.

2. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under the provisions of Section 22(a) of the Revenue Act of 1934 and the rule laid down by this Court in *Helvering v. Clifford,* 309 U. S. 331, on the grounds that the Janirv Trust was lacking in substance and the grantor's control of the trust corpus was such as to require that he be considered the owner thereof.

3. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under Section 22(a) of the Revenue Act of 1934 because such an application of said section for the purpose of taxing the grantor of a valid trust on income distributable to other persons would be unconstitutional.

V.

ARGUMENT.

1. The Court of Claims erred in failing to decide that the Janirv trust was not a trust, the income of which is taxable to the grantor by reason of the provisions of Section 166 of the Revenue Act of 1934.

The income tax deficiency and interest paid by Irving J. Reuter, your petitioner, which was sought to be recovered in a suit instituted in the Court of Claims of the United States, was originally assessed against petitioner under authority of Section 166 of the Revenue Act of 1934. Plaintiff's initial contention is that this Section has no application to the income of such a trust as is involved in this proceeding. The Court of Claims in its decision failed, however, to pass on this question.

Section 166 provides that the income of a trust shall be taxed to the grantor where the grantor has a power to require the revestment of the corpus of the trust in him-

self. In the instant case, however, the grantor early in 1932 created a trust which was to be irrevocable for a period of five years from and after January 1, 1932, and merely provided that he should have the right to terminate the trust after the expiration of this five-year period provided notice in writing of such election to terminate should have been served upon the beneficiaries at least thirty days prior to the expiration of the period. In the event that the grantor did not survive the minimum life of the trust or failed to give proper notice of his intention to terminate, the trust was to continue for an additional period of five years and upon termination, its corpus was to be distributed to remaindermen other than the grantor.

It is apparent that the grantor in the instant case did not retain any power through the exercise of which he could have secured a retransfer to himself of title to the trust corpus at such time as to permit him to enjoy any income which the trust might receive during 1934. The income of this trust was designated irrevocably to be paid to the named beneficiaries, not including the grantor, for a period of at least five years.

Furthermore, it is apparent that the grantor under the terms of the Declaration of Trust was not "vested" with any "power" to secure the revestment of title to the trust corpus in himself. A power that cannot be exercised is not a power at all or is at most only a contingent power. *Corning* v. *Commissioner,* 104 F. (2d) 329.

It was necessary that a period of five years elapse before the grantor of the Janirv Trust Fund could exercise any power to terminate the trust. A power which can only be exercised after a lapse of years is contingent upon the grantor surviving until the period has passed. If the grantor failed to survive, his contingent or inchoate power to revest would never become an actual exercisable power

and, by the terms of the trust instrument, the corpus would be distributable to an irrevocably named person. It may be noted that the grantor did not retain any rights to change the named beneficiaries or to exercise any power of appointment over the trust corpus by will or otherwise. Consequently, it was only in the event of his surviving the five-year period that he was able to acquire any right through the exercise of which he might either secure the revestment of the trust property in himself or direct its disposition to others. Accordingly, the "power" possessed by the grantor in the instant case is at most a "contingent" or "inchoate" power and accordingly within the rule of the *Corning* case, cited above.

Therefore, in the instant case, the grantor was not *vested* with any *power* to revest the *corpus* of the trust in himself within the meaning of Section 166 of the Revenue Act of 1934. This is the conclusion reached by the Board of Tax Appeals in interpreting the identical trust instrument here involved in the case of *I. J. Reuter* v. *Commissioner,* B. T. A. memorandum opinion entered July 30, 1940. The Board's opinion in this case is based upon the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344.

Finally, since there is no provision in the trust instrument for the accumulation of that portion of trust income the taxation of which is here in question, and since the income is not to be used to pay any obligations of the grantor, to pay insurance premiums on his life or to be used in any way for his benefit, it is accordingly clear that Section 167 of the Revenue Act of 1934 does not apply. It follows that the petitioner is not taxable as grantor of the trust in respect to the income of the trust and that the tax which he paid in respect to such income should be refunded to him. The Court of Claims of the United States was in error in failing to so decide.

2. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under the provisions of Section 22(a) of the Revenue Act of 1934 and the rule laid down by this Court in Helvering v. Clifford, 309 U. S. 331.

The decision of the Court of Claims of the United States rests solely upon the determination that the instant proceeding is governed by the decision of this Court in *Helvering* v. *Clifford, supra.* Your petitioner, however, contends, first, that the decision in this case did not establish any general principle that the income of all short-term trusts should be taxed to the grantors thereof, even where the grantor and the trustee were a single person; and, second, that the facts of the instant proceeding are different in material respects from the facts in the *Clifford* case and warrant the application of a different rule.

In the first place, it may be noted that the Revenue Act of 1934 provides for the taxation of trust income under Sections 161 and 162, subject to exceptions (requiring taxation of the income to the grantors of trusts) contained in Sections 166 and 167. Sub-Title B of the Act of which Section 22(a) is a part provides for the taxation of individuals and contains no reference whatever to trusts or the income of trusts. It follows that the determination of this Court that the income of the trust in the *Clifford* case was taxable to the grantor thereof by reason of the provisions of Section 22(a) is equivalent to a determination that in the *Clifford* case, to all intents and purposes, no trust existed. To tax the income of a trust to the grantor "under Section 22(a)" is to say that the trust is so lacking in substance and reality as to leave the *corpus* of the trust throughout its term essentially the property of the grantor.

Your petitioner therefore believes that this Court in its decision in the *Clifford* case was not establishing a general

principle that the income of all short-term or vested-term trusts should be taxed to the grantors thereof. Such a principle in its very nature would be repugnant to the entire structure and purpose of the revenue statutes of the United States.

In numerous cases this Court, in dealing with the taxation of trust income, has found—based upon the special facts of the cases involved—that the grantor had failed to relinquish dominion and control over the *corpus* of the trust which he had purported to create to a sufficient degree to establish a valid trust. The conclusion naturally followed that, if the grantor remained in effect the owner of the *corpus*, the liability for the payment of tax on the income from the *corpus* remained upon him. See *Burnet* v. *Wells*, 289 U. S. 670; *Dupont* v. *Commissioner*, 289 U. S. 685.

From this it follows that the decision in the *Clifford* case should be treated by lower courts as having been based upon the special facts presented to this Court in that case. The decision of the Court of Claims in the instant case rests upon an analysis of the special facts of the instant case. In spite, however, of the wide divergencies in the facts of this case and the *Clifford* case, the Court of Claims held—petitioner maintains erroneously—that the two cases "are similar in all respects and the provisions in the two trusts are almost indistinguishable". Petitioner believes that this finding constitutes error.

The entire structure and phraseology of the Declaration of Trust in the *Clifford* case suggests an intention on the part of the grantor to relinquish as little control as possible over the property involved. The grantor begins not by explicitly transferring or conveying the property in question to a trustee but merely by stating "I * * * do hereby acknowledge and declare that I do and will hold all of the same (referring to the property in question) and all my right, title and interest therein as a trust estate

* * *." He then proceeds to declare that the income of the trust estate shall be held for the exclusive benefit of his wife, but provides that he as trustee may distribute such income or any part of it to her at any time or withhold all of such income as he may determine. Upon the termination of the trust at the expiration of its five-year period, the undistributed net income "shall be deemed and treated as property owned absolutely by" the beneficiary, although there is no provision for its distribution to her.

Moreover, the structure of the *Clifford* trust indicates the full intention of the grantor to resume ownership of the *corpus* on termination. The trust was to terminate in five years or upon the prior death of either the grantor or his wife. Upon termination, however effected, the principal of the trust "shall be deemed and treated as property owned absolutely by me". This provision is not altered to take account of the possible termination of the trust as a result of the death of the grantor himself. Even in this event, the trust *corpus* would not go over to the beneficiary. The instrument of course contains no provision for the appointment of a successor trustee or any provision looking to a possible continuation beyond the five-year period. On the contrary, at the expiration of such period "the trust hereby created shall forthwith and without any further act or deed terminate".

Finally, the grantor in the *Clifford* trust reserves to himself such unusually extensive powers of control over the trust *corpus* as to explain the conclusion of this Court that he intended to retain the right to treat the trust property substantially as if it were his own. He retained the right to exercise all voting powers of stocks in the trust; to keep the registry in his own name or in the names of his nominees; to dispose of any assets freely upon any terms determined by himself; to invest the proceeds in any sort of personal property whatsoever "* * *, without restriction because of the speculative character of the investment or the rate

of return therefrom or any laws pertaining to the investment of trust funds"; and to lend such proceeds "with or without security". These powers were coupled with a provision relieving the trustee of liability to the life beneficiary for any loss of any kind, except resulting from willful and deliberate violation of the terms of the trust. Finally, it may be noted that the grantor's control of the income, which was absolute during the five-year period, is extended by the provision that not only stock dividends and proceeds from the sale of subscription rights but also "extraordinary cash dividends", should be excluded from income and should become part of the corpus, to be returned to the grantor upon the termination of the trust.

It was on the basis of the foregoing facts that this Court concluded:

> "In this case we cannot conclude as a matter of law that respondent ceased to be the owner of the corpus after the trust was created. * * * So far as his dominion and control were concerned it seems clear that the trust did not effect any substantial change."

In the present case we are dealing with a trust of materially and substantially different character. The Janirv Trust was to continue irrevocably for a period of five years but, unlike the trust in the *Clifford* case, would not terminate at the expiration of five years unless prior notice had been given by the grantor. In the absence of such notice, the trust became absolutely irrevocable at the end of the five-year period. It is apparent that the grantor contemplated such continuance, since he provided in the Declaration of Trust for the appointment of successor trustees and included provisions relating to their powers and authority. Likewise, he provided that if he did *not* survive the minimum life of the trust, the trust should nevertheless continue and, upon termination, the property should be distributed to named remaindermen. From all of the foregoing it is entirely clear that petitioner, in establishing the Janirv Trust,

parted with his individual control of the property constituting the corpus of the trust and subjected that property to the fixed control of the provisions of the instrument, which not only deprived him definitely of all rights to the current income, but under certain contingencies would have completely alienated his ownership in the corpus itself.

Even more significant perhaps, the grantor did not retain the quality of control over the income of the trust which is present in the *Clifford* case. The trust instrument required that the income from the General Motors Securities Company stock (the only portion of the income here in question) *had* to be distributed currently to the beneficiaries. As to such distribution, the grantor retained no option or any form of control over the income of the trust. Moreover, these beneficiaries included not only plaintiff's wife but also his parents and it is clear that one significant purpose of the trust was to provide in all events an income for these parents. They are protected in the enjoyment of this income even if the trust terminates by reason of the deaths of the grantor and his wife. It certainly cannot be said here, as in the *Clifford* case, that the trust was "at best a temporary reallocation of income within an intimate family group".

Finally, the trust powers retained by the grantor in the Declaration of Trust of the Janirv Trust were merely the normal powers incident to a relationship of trusteeship. The trustee was given the right to sell and transfer the property and was required to reinvest the proceeds of sale, his investment power being limited to "income-producing securities". He was empowered to divide the trust estate in kind upon termination and to compromise and settle claims and was required to provide proper annual reports of the financial transactions of the trust. These are normal trust powers and duties such as are to be found, of necessity, in substantially every trust instrument.

Your petitioner submits that they are not powers of such

unusual character as to warrant the characterization of the Court of Claims contained in the statement: "Broad and almost unlimited powers were bestowed upon the trustee to deal with the trust property upon such terms and conditions as he deemed best." On the contrary, it is submitted that it is impossible to say in the instant case, as this Court said in the *Clifford* case, that plaintiff "retained the substance of full enjoyment of all the rights which previously he had in the property". Specifically, here the grantor was limited in the type of investments he could make; was required to keep the corpus invested; was required to render annual statements, and, most important of all, was required to pay the income currently to the life beneficiaries.

In view of all the foregoing, petitioner denies that the facts of this case bring it within the rule of the *Clifford* case and submits that the Court of Claims was in error in so holding.

However, if petitioner did not "retain the substance of full enjoyment" of the trust corpus, but on the contrary parted with substantial rights to the income of the trust and subjected himself to the possibility of the permanent alienation of ownership of the property involved, then a true trust was created and Section 22(a) of the Revenue Act of 1934 has no application whatsoever to the taxation of its income.

3. The Court of Claims erred in deciding that the income of the Janirv Trust was taxable to the grantor thereof under Section 22(a) of the Revenue Act of 1934 because such an application of said section for the purpose of taxing the grantor of a valid trust on income distributable to other persons would be unconstitutional.

Finally, petitioner submits that the decision of the Court of Claims in the instant proceeding involves an application of Section 22(a) which is contrary to provisions of the Con-

stitution of the United States. The power of Congress to levy an income tax is not an unrestricted power. It arises by virtue of the Sixteenth Amendment to the Constitution which permitted Congress "to lay and collect taxes on incomes from whatever source derived without apportionment among the several States or without regard to any census or enumeration". Congress cannot under the authority of the Sixteenth Amendment levy a tax under the guise of an income tax on that which is not income. *Eisner* v. *Macomber,* 252 U. S. 189.

Clearly, however, the term "income" connotes not only an amount of money or wealth received, but also a recipient. To levy an income tax is to impose a liability upon a taxpayer on account of his receipt of income and not the receipt of income by someone else. Income is "income" only to its own recipient. Stated otherwise, a tax on A measured by B's income is not an income tax. *Hoeper* v. *Tax Commission of Wisconsin,* 284 U. S. 206; *Nichols* v. *Coolidge,* 274 U. S. 531.

This Court has not hesitated to hold that an arbitrary and capricious impost under the guise of the exercise of the taxing power was not "the exertion of taxation but confiscation of property, that is, a taking of the same in violation of the Fifth Amendment". *Brushaber* v. *Union Pacific Railroad Company,* 240 U. S. 1. But what can be more arbitrary and capricious than imposing a tax on the grantor of a trust in respect to income of the trust which he does not receive, which has not been used for his benefit but has been distributed to the trust beneficiaries and which he is utterly unable to secure to himself by any act whatsoever which it is within his legal right to do?

Nevertheless, such is necessarily the result of the establishment of any principle that the income of short-term trusts is by reason of Section 22(a) of the Revenue Act of 1934 to be taxed to the grantors thereof. Such an applica-

tion of the statute would, it is submitted, render it unconstitutional and would constitute an arbitrary exercise of power repugnant to the terms of the Fifth Amendment and wholly beyond the scope of the Sixteenth Amendment.

WHEREFORE it is respectfully urged that the petition of Irving J. Reuter for writ of certiorari to the Court of Claims of the United States filed herewith be granted by this Honorable Court in order that the erroneous interpretation of the Court of Claims of the decision of this Court in *Helvering* v. *Clifford, supra,* may be corrected and in order that an improper and unconstitutional application of Section 22(a) of the Revenue Act of 1934 may be avoided.

Respectfully submitted,

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